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EFFECTS OF MANAGEMENT PROFICIENCY ON FINANCIAL PERFORMANCE OF FOREIGN COMMERCIAL BANK, KENYA

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***Abstract: Purpose*; The study sought to examine Management Proficiency on financial performance of foreign commercial banks in Kenya from period of 2013 to 2019.**

***Design/Methodology/Approach*; The return on equity (ROE) and return on asset (ROA) were used as measure on measure of financial performance measures on foreign commercial banks in Kenya. The descriptive, correlation and panel regression analysis based on fixed effect model with help STATA.**

***The Results*; It indicated that an R squared of 0.6956 was obtained that implies that 69.56 percent of the variations in financial performance of foreign commercial banks in Kenya was accredited to capital adequacy, asset quality and management efficiency. A p-value of 0.0000 further endorsed that the variables that were used namely: capital adequacy, asset quality and management efficiency had significant effect predicting the financial performance of foreign commercial banks in Kenya. The model had a constant value of 0.87 thus inferred that in the absence of capital adequacy, asset quality and management efficiency, the value of financial performance of foreign commercial banks in Kenya was 0.87.**

***Originality/value:* The main study objective was to provide the empirical evidence on management proficiency on financial performance on foreign commercial banks in Kenya and demanded literature gaps**

***Keywords*: Financial performance, Asset quality, Capital Adequacy and management efficiency.**

1. INTRODUCTION

Financial performance involved how the firm make use of its available resources to generate revenue. According to Adeniyi, Omisakin, Oyinla and Egwaikhide (2012) asserts that operating income, net asset value, earnings before taxes and interest are measures of firms financial performance. To measure Firms performance we ought to contemplate several performance indicators (Agbloyor, Abor, Adjasi and Yawson, 2014). Choosing a particular financial productivity degree rests on how appropriately fits the set Determination. According Charlton and Alfaro (2013) find in a bank case, financial productivity is regarded a generating profit that is enough to cover operational expenses. Therefore, a bank to perform financially it needed to use and utilize well its assets available to create value for shareholders wealth and increase strong asset base through its retained (Azman, law, & baharumshah, 2010).

Jar and Al-khawaldeh (2014) studied banks in Jordan to establish the factors that contributed to productivity on profit-making tiers and examined the extent to which bank performance is influenced by internal and external factors. They found interior elements to have significant impact; however capital capability, liquescency and bank magnitude inconsequential. With regards to the peripheral causes, Gross domestic product (GDP), inflation, and stock market

capitalization to total properties have a noteworthy effect on performance. Additionally, a study by Fan-Fah, Ariff and Nasserinia, Ariff (2014) investigated how particular bank specific elements and quite a lot of market and macro-economic elements influence the fiscal performance of commercial establishment. From the elements of the study showed positive output for Outcome net charge margin (NCM) is a vital productivity factors and that adverse associations existed among credit threat, assets sufficiency and NCM while an optimistic relationship was evident between the variables, asset quality, liquescency risk, regulation value and NIM. Concentration of Bank has optimistic effect on banks in Japan but though the effects of revenue divergence and size were positive they were not noteworthy. The business environment, GDP progress and supply of money have adverse and substantial associations on output nevertheless, their influence are not as robust as those of tier- particular factors.

According to Ogilo (2012) using variables in the CAMEL (Capital adequacy, Asset Quality, Management, Earnings, Liquidity) found the factors associated with the economic productivity of lender banks, mainly focusing on Capital Capability, Asset Superiority and Management. Nimalathasan (2008) finds that CBK uses CAMEL to supervise banks financial health. Recently, many researchers have shown interest in investigating the contributing factor of bank performance and examined the association among these factors and the profitability of banks (Nouaili, Abaoub & Ochi, 2015).A examination by Seelanatha (2010) who studied how market organization and bank effectiveness impacted the inclusive Sri Lanka commercial banks productivity. Used net charge margin and asset returns as performance indicator as well as Structure-Conduct-Performance (SCP). It found that customary SCP hypothesis does not apply in the banking business in Sri Lank. The bank productivity was not influenced by individual firm market dominance and Concentration but competence was the main driving factor that drove growth of the banking businesses.

Lipunga (2014) examined the contributing factor on performance of listed profit making banks in emerging countries, case of Malawi. The search covered of four years from 2009 to 2012. It used Earnings Yield (EY), and Assets return (ROA) in measuring bank productivity. The search used multivariate regression analysis it indicated that bank magnitude, liquescency and management proficiency have a statistically influence while capital sufficiency was inconsequential. In terms of Earnings Yield however, bank size, capital capability and management productivity had a significant influence on bank performance but not liquidity.

Echeboka (2014) performed a search attempted to explore the impact of CAMEL components on the productivity of Nigerian banks. The covered 10 years from 2001 to 2010. Study applied Ordinary Least Square (OLS) method. The results of the study established on the CAMEL model, revealed that only the liquidity of the banks under consideration had a substantial influence on bank productivity whereas capital adequacy, asset superiority, earnings and management effectiveness did not. These findings were contradictory to those of the study by Uzhegova (2015) which indicated that all CAMEL components had a substantial effect on bank productivity. According to Kusa and Ongore (2013), in their study, also found that capital capability, liquescency and asset value as vital factor in bank's commercial performance.

1.1 Banking Sector in Kenya

Kenya's financial industry started back in colonial reign by Europeans presence in Africa. Indian national bank was the first one to establish operations in Kenya in Mombasa in 1896. Later after 11 years of independence in 1963, twelve other commercial banks were already registered in and operating in Kenya by the year 1972. The lending sector has continued to grow, as by the year 2014, there were 1 mortgage firm and 44 commercial banks licensed and operating business in Kenya. The financial sector has 8 foreign bank representative, nine micro finance bank, 13 money remittance establishments, and two credit reference bureaus (Central bank annual Report, 2014).

The Financial industry play vital role in the Kenyan Economy for many decades. The major contribution of the financial are as follows. The banking sector has played intermediary role where the banks connects those with cash surplus loan with those with cash deficit when they use as the investment. According to World Bank (2010), banks play a significant role of on money circulation and cash mobilization in the economy helps other sectors to develop and spill over to other sectors which in the result helps economic growth. The government recognizes the major benefits accrued by the commercial entities in the nation and through central bank as a regulator. The Government through legislation it directs central bank to give banks directives on the rates which the loans can be given to specific sectors, that benefit to accelerate the economic growth. In Kenya only few banks that control the financial market as 48% is only controlled by 6 banks out of the 44 banks in Kenya (Bank supervision report, 2014). Therefore, it means that the customer base is run by few large profit making financial firms. That is the situation for bank to make a profit or have a return it must diversify its

portfolio's so its combination of asset and security is different. With the aim to get the objectives the banks invest on securities and assets that have risks that match with the expected return. This is achieved by investing in various sectors that have different risks. The decision is achieved by calculation of expected cash flow and anticipated risk in relation to investment intended to for invest.

1.1.1 Foreign Commercial banks In Kenya

The existence of foreign banks have long history before the independence in the year 1963.For the past decades the foreign banks have dominated the Africa and Kenyan banking sector for long period until government established own banks and initiated policies encourage local financial establishment. Foreign commercial banks continue dominate financial sector in some states in Africa. In particular, there are 14 foreign commercial bank licensed to operate financial services by (CBK, 2015).

The Kenya's financial sector history started in 1896 when National bank of India was established by the British administration in East Africa. Later in 1910, standard bank of South Africa was also licensed to offer financial services. Six years later in 1916 the then Anglo Egyptian bank and National bank of South Africa merged to form Barclays bank to present its ABSA. According to Kamau (2009) opined that foreign commercial banks have benefited to host country such as they bring the technology and capacity that is transferred to local banking operators in the economy. Foreign banks have huge liquidity base due to large and strong financial base from the parent firms abroad

According to Fuch (2004) asserted that in developed states foreign banks are making less profit due to taxes regimes. They further found that in developing nations especially in Asia and Africa the foreign banks have reported huge profits than local banks due to preferential treatment and use of technologies advantages. They further noted that local bank also make decent profits due to familiarity with the local norms and virtues. Despite them making decent profits in the country, chase bank and Imperial banks were declared insolvent by Central bank of Kenya in year 2015. The reason attributed is poor financial management by the governing executives in the respective banks.

2. LITERATURE REVIEW

Cyree and Morris (2018) conducted a research on the role of market demographics in determination of banks productivity, by using a sample of sole county bank. The study employed descriptive research plan. The researchers found that market demographics played a key role in determination of productivity of commercial institutions. Profitability was measured in terms of yield on equity, yield on assets, and investment returns. Mwai (2018) examined the connection between capital prerequisite and performance of Central Banks in Kenya. Descriptive research design was assumed during the study. The findings showed that there was a positive and significant association amongst minimum core capital and performance of Central Bank of Kenya. In addition, the finding revealed that there was a significant association between capital obligation and performance of financial banks which was measured in terms of assets returns and equity returns. Ongore and Kusa (2013) explained that enough capital is necessary for liquidity purposes as bank deposits can susceptible to bank runs. Capital capability is thus, a suggestion of lenders capital strength in terms of insolvency risk. Capital adequacy ratio (CAR) is commonly expressed by the sum of Tier I Capital and Tier II Capital as a fraction of a bank's risk weighted assets (Swarnapali, 2014). Altan et al. (2014) also asserted the need for asset quality analysis is to determine the amount of un-performing assets as a fraction of the total assets. Asset quality of a commercial bank is thus mainly observed on the basis of the bank's ability to recover its unpaid loans and advances in due time and this is presented by the proportion of unpaid debts to total gross advances given out (Kabir & Dey, 2014). Similarly, Echeboka (2014) as the ability for managers to determine and control the risks involved in a bank's activities and to ensure compliance with regulation in the efficient implementation of banking activities.

3. METHODOLOGY

The study employed factors capital adequacy, asset quality and management efficiency of the 14 foreign commercial banks in Kenya from 2013 to 2019. The list of the foreign commercial banks is at appendix 1. The financial data(balance sheet data) were collected from central bank of Kenya for the 14 banks in Kenya. The study used social statistical package (STATA) for data analysis. The study used panel regression model, the data results were presented in forms tables for interpretation.

$$Y_{it} = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \varepsilon_{it}$$

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Y_{it} is the dependent variable (Foreign commercial Banks performance), $\mathbf{B_0}$ is the y intercept (Constant), β_1- β_3 are coefficients of determinants, X_{1it} is the Capital Adequacy, X_{2it} is the Asset Quality, X_{3it} is Management Effeciency. **i** is the observation of data in previous Quarter, **t** This is current observation of current quarter; ε_{it} is an error term.

The study adopted various diagnostics tests which were carried out to ascertain that the research data meet the underling requirements of classical linear regression model (CLRM). These tests included test for stationarity, multicollineraity, heteroskedasticity and hauman test.

4. FINDINGS

4.1 Descriptive Statistics

The descriptive statistics include the mean, minimum and maximum values with standard deviation of the study variables.

Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Financial Performance	98	0.56	0.16	-0.67	1.15
Capital Adequacy	98	0.15	0.06	-0.09	0.38
Asset Quality	98	0.11	0.12	0.00	0.69
Management Efficiency	98	2.23	12.04	-70.16	69.45

Based on the descriptive analysis, financial performance had a mean and standard deviation of 0.56 and 0.16 respective which indicates high level of dispersion in the financial performance of foreign commercial banks in Kenya. This is further supported by a minimum value of -0.67 and maximum value of 1.15. Capital adequacy had a mean of 0.15, standard deviation of 0.06, minimum value of -0.09 and maximum value of 0.38. This implies that capital adequacy relatively fluctuated within the study period. Asset quality had a mean of 0.11 and standard deviation of 0.12 which indicates minimal dispersion within the study period. Management efficiency had mean of 2.23, standard deviation of 12.04, minimum value of -70.16 and maximum value of 69.45, which indicates high fluctuation over the study period. All the study variables each had a total number of observations of 98.

4.2 Panel Regression Analysis

The study utilized panel regression analysis based on fixed effect model.

Financial Performance	**Coef.**	**Std. Err.**	**T**	**P>|z|**	**[95% Conf.**	**Interval]**
Capital Adequacy	-2.276434	1.538297	-0. 83	0.422	-4.599722	2.046854
Asset Quality	-.2873478	0 .0077565	-37.05	0.000	-0.3041048	-0. 2705909
Management Efficiency	0.0065359	0.0078642	0.83	0.421	-0.0104538	0.0235255
_cons	0.8716876	0.2101432	4.15	0.001	0.4177009	1.325674
R^2 =0.6956						
F statistics=570.30						
Prob> chi2=0.0000						

An R squared of 0.6956 was obtained which implies that 69.56 percent of the variations in financial performance of foreign commercial banks in Kenya can attributed to capital adequacy, asset quality and management efficiency. A p-value of 0.0000 further indicates that the variables used namely: capital adequacy, asset quality and management efficiency are significant in predicting the financial performance of foreign commercial banks in Kenya. The model had a constant value of 0.87 which implies that in the absence of capital adequacy, asset quality and management efficiency, the value of financial performance of foreign commercial banks in Kenya is 0.87.

4.3 hypothesis one

The findings of the regression analysis reveal a coefficient of -2.27 and p-value of 0.42. This therefore implies that capital adequacy has insignificant effect on financial performance of foreign commercial banks in Kenya. The insignificant effect can attributed to the notion that commercial banks are mandated to maintain certain levels of capital in line with the capital adequacy regulation by the Central Bank of Kenya. As such, due to the costs associated with breach of this guideline, banks strive to achieve the minimum capital requirements. . The study findings on the effect of capital adequacy on financial performance of foreign commercial banks in Kenya collaborate those in literature. Ongore and Kusa (2013) and (Onuonga, 2014) similarly documented that capital adequaucy had insignificant effect on financial performance of commercial banks in Kenya. Additionally, Githire and Muturi (2015) on financial performance of firms listed at the Nairobi Securities Exchange, documented that capital adequacy had insignificant on financial performance of commercial banks.

4.4 Hypothesis Two

The findings from the regression analysis indicate -0.28 and 0.000 as coefficient and p-value respectively. This therefore implies that asset quality has a significant effect which is negative on financial performance of foreign commercial banks in Kenya. The significant effect can linked to the fact that commercial banks largely raise revenues through the financial intermediation role of lending. The higher the levels of non performing loans, the lower the funds available for banks to lend to borrowers and thus, leading to declining financial performance. Additionally, high rates of non performing loans lead to higher levels of bad debts which are subsequently written off against the profitability of commercial banks.

The study findings on the effect of asset quality on financial performance of foreign commercial banks are in agreement with those of previous studies. Echeboka *et al*. (2014), Altan *et al*. (2014) and (Kabir & Dey, 2014) documented that asset quality has significant effect on financial performance of commercial banks. Similarly, Ongore and Kusa (2013) and Onuonga (2014) reported that asset quality has significant effect on financial performance of commercial banks in Kenya. Additionally, Muhman and Hashim (2015) also documented that asset quality strongly predicted the financial performance of banks in Malaysia.

4.5 Hypothesis Three

The findings from the regression output revealed a coefficient of 0.006 and a p-value of 0.421 which indicates non significance. The findings therefore imply that management efficiency has insignificant effect however positive effect on financial performance of foreign commercial banks in Kenya. A unit increase in management efficiency increases financial performance of foreign commercial banks in Kenya by 0.006, however insignificantly.The study findings on the effect of management efficiency on financial performance of foreign commercial banks in Kenya collaborate with those of past studies. Ongore and Kusa (2013) found that management efficiency had insignificant positive effect on financial performance of commercial banks in Kenya. Nimalathasan (2008) and Echeboka et al. (2014) documented that management efficiency had insignificant effect on financial performance of commercial banks. Also, Muhmad and Hashim (2015) and Sangmi and Nazir (2010) found that management efficiency had insignificant effect on financial performance of commercial banks. Mohiuddin (2014), Sufian and Kamarudin (2012) also found that management efficiency had insignificant effect on financial performance of commercial banks.

5. CONCLUSION

With respect to the effect of capital adequacy on financial performance, the study documented that capital adequacy is not significant in predicting the financial performance of foreign commercial banks in Kenya. This therefore implies that the variations and movements in capital adequacy do not significantly affect the financial performance of foreign commercial banks in Kenya. With respect to the effect of asset quality on financial performance, the study concludes that financial performance of foreign commercial banks in Kenya is significantly influenced by asset quality. This can further supported by the notion that increasing levels of non -performing loans similarly implies high levels of bad debts which are ultimately written off against the profits of commercial banks and thus hampering their financial performance. Lastly, the study concludes that management efficiency does not significantly impact on the financial performance of foreign commercial banks in Kenya.

5.1 Future Implications

- Additional, studies can further look at how bank size moderates the relationship tween management efficiency and financial performance of foreign commercial banks in Kenya.
- Further studies can focus on the entire commercial banks in Kenya as this was useful for comparison purposes. Other studies to use variables of central bank regulations like reduced interest rates, look at effects of removed charges on mobile transfer during the Covid 19 as caution on vulnerable by the government on financial performance of commercial banks in Kenya.
- Another study to use variables capital adequacy, asset quality and management efficiency and moderating factor financial policy on financial performance of foreign commercial banks in sub Saharan Africa.
- Further research can focus on impact of covid 19 and government's financial measures to curb on financial sector in Kenya.

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APPENDIX - A

Appendix 1: Sampling Frame

1 BARCLAYS (ABSA)

2 BANK OF AFRICA

3 BANK OF BARODA

4 BANK OF INDIA

5 CITIBANK

6 CREDIT BANK

7 DIAMOND TRUST BANK

8 FIDELITY COMMERCIAL BANK

9 HABIB BANK

10 HABIB BANK AG ZURICH

11 PRIME BANK

12 STANDARD CHARTERED

13 UNITED BANK OF AFRICA

14 TRANSNATIONAL BANK